

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
TWO PINE STREET COMPANY )

Appearances:

For Appellant: Everett S. Layman, Jr.  
Attorney at Law

For Respondent: John D. Schell  
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Two Pine Street Company against a proposed assessment of additional franchise tax in the amount of \$67,004.38 for the income and taxable year 1967.

Appellant was incorporated under the laws of California on December 15, 1965, and adopted the calendar year for franchise tax purposes. Porter Sesnon, his sister, Barbara Sesnon Cartan, and her husband, Henry Cartan, were the incorporators and directors. Mr. Sesnon and Mrs. Cartan, hereafter referred to as the Sesnon Interests, were the sole shareholders. On March 11, 1966, they received all of the capital stock in appellant and a \$500,000 promissory note. In exchange for the stock and note, appellant received from the Sesnon Interests a nine-story office building in San Francisco, California, called Number Two Pine Street and certain personal property therein. The transfer took place one day after appellant obtained a permit from the Commissioner of Corporations to issue the stock. The property was acquired subject to a trust deed securing a \$1,500,000 loan made to the Sesnon Interests.

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According to its articles of incorporation appellant was formed to engage in operations relating to land, office buildings, and other buildings of any kind. Commencing March 11, 1966, appellant's only source of income was from the rental of the subject real property. Prior thereto the rental receipts had belonged to the Sesnon Interests.

On November 6, 1967, appellant adopted a plan of complete liquidation, and pursuant thereto, on November 16, 1967, sold all of its property to Fireman's Insurance Company, distributing the proceeds of the sale to its shareholders on December 28, 1967, and filing a certificate of winding up and dissolution with the Secretary of State on January 5, 1968.

The question raised by this appeal is whether appellant should be regarded as doing business for a full calendar year in either 1966 or 1967. In maintaining that it was doing business during the entire year 1966, appellant relies upon the following events which occurred shortly before and after its incorporation:

1. June 1965 - The Sesnon Interests contracted to purchase the real and personal property known as Number Two Pine Street for a cash price of \$3,000,000 from the American Sugar Company.

2. August 1965 - The Sesnon Interests met to consider incorporation of those assets, and their attorney was instructed to reserve a corporate name. On August 20, 1965, the Secretary of State issued a certificate of reservation of the corporate name of Two Pine Street Company.

3. September 1965 - The sale of assets from American Sugar to the Sesnon Interests was consummated. Conferences were held between Sesnon Interests and their advisors to discuss the details of incorporation of appellant and its acquisition of the Number Two Pine Street property.

4. December 1965 - Instructions were given to an attorney to prepare the necessary documents relating to the pending exchange of property for stock, and to draft a request to obtain the requisite permits from the Commissioner of Corporations. Incorporation of taxpayer occurred. Conferences were held with respect to the corporate operation, the take-over from the Sesnon

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Interests, the change of records, and compensation of corporate executives.

5. January 1 - January 16, 1966 - The Sesnon Interests obtained a \$1,500,000 loan from Aetna Life Insurance Company on January 3, securing the loan with a trust deed on the property. A conference was held to consider corporate problems relative to payment of the promissory note to the shareholders, depreciation for tax purposes, and executive compensation. A board of directors' meeting was held on January 4 at which time Number Two Pine Street was established as the principal office; corporate bylaws, seal, and form of common stock certificate were adopted; authorization was given to file for a permit to sell stock and deliver the note for Number, Two Pine Street; and the fair value of consideration for which the stock was to be issued was set at \$1,000,000.

On its franchise tax return for the short taxable year ended December 31, 1965, appellant stated it was inactive and paid the minimum tax. On its return for the taxable year 1966 it stated that it began business on March 11, 1966. Depreciation and amortization schedules were computed on the basis of operations for 9-2/3 months of the year 1966. The return for 1967 again indicated that appellant began business on March 1.1, 1966.

Section 24512 of the Revenue and Taxation Code provides :

If - -

(a) A corporation, other than a corporation described in Section 23222 or 23222a, adopts a plan of complete liquidation on or after December 31, 1954; and

(b) Within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims;

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

The parties agree that appellant was a commencing corporation described in section 23222 during its first taxable year, December 15, 1965, through December 31, 1965. The

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question for consideration here, therefore, is whether appellant was a corporation described in section 23222a both in 1966 and 1967, thereby being excepted from the nonrecognition benefits of section 24512 cited above'. A corporation described in section 23222a includes a commencing corporation whose second or succeeding taxable year constitutes one in which the taxpayer does business for a period of less than 12 months,

Respondent contends that, in addition to appellant being a corporation described in section 23222 for 1965, it was a corporation described in section 23222a during the rest of its corporate existence, and thus excluded from the nonrecognition of gain provisions of section 24512 of the Revenue and Taxation Code.

Respondent bases its contention on its conclusion that appellant did not do business for either the entire year 1966 or the entire year 1967. With reference to the question of whether or not a commencing corporation has done business for a full year, respondent's regulations provide that "a period of more than one-half a calendar month may be treated as a period of one month." (Cal. Admin. Code, tit. 18, reg. 23221-23226, subd. (b).) Thus, respondent concedes, insofar as 1966 is concerned, that if appellant commenced business, on or before January 16, 1966, it may be considered to have done business during the entire year 1966. With respect to 1967, respondent additionally contends that the date for determining whether appellant was a corporation described in section 23222a is the date the plan of liquidation was adopted, in this case November 6, 1967. Accordingly, respondent argues that even if appellant was doing business for the entire year 1967 it would still have been a section 23222a corporation at the correct time for determining its status (November 6, 1967), and thereby not entitled to the benefit of the nonrecognition of gain provisions of section 24512.

Appellant contends that because distribution in complete liquidation must occur to obtain the benefit of section 24512, the time of complete liquidation must be considered the point in time to determine whether a taxpayer is a corporation described in sections 23222 and 23222a. Appellant contends that liquidation is not complete until the date of filing the final certificate of winding up and dissolution with the Secretary of State which, in accordance with section 23331 of the Revenue and Taxation Code, is the effective date of dissolution. Appellant contends that it did business for the entire year 1967 and that because the certificate of winding up and dissolution was not filed until

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January 5, 1968, that it was then no longer a section 23222a corporation and therefore entitled to obtain the benefit of section 24512. In the alternative, appellant maintains it did business for the full calendar year 1966, and thereby was not a section 23222a corporation even in November 1967.

We believe that the crucial date for determining whether a corporation is still a section 23222a corporation is the date the plan of liquidation is adopted. References to time in the particular code provision all refer to the date of adoption of the plan. Furthermore, appellant's construction would render the exception Clause almost totally ineffective. To escape the exception a commencing corporation would need only to delay the filing of its certificate of dissolution beyond the end of its first full 12-month income year even though it had adopted a plan of complete liquidation and sold its assets shortly after it had begun its operations. In any event, it is clear that appellant did not do business for a full 12 months in 1967. Section 23101 of the Revenue and Taxation Code defines "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." Following the sale of all its assets in November 1967 all it had to do was to pay its liabilities and distribute the proceeds in accordance with the previously adopted plan. Such acts do not constitute doing business by a corporation. (Appeal of Johnson Foundry & Machine Co., Cal. St. Bd. of Equal., Nov. 17, 1948.)

In reviewing the year 1966, we are of the opinion that appellant did not begin doing business within the meaning of section 23101 prior to March 11, 1966. The activities relied upon by appellant as occurring on or before January 16 were all activities preliminary to "doing business." They consisted of taking steps leading to incorporation, or to the acquisition by appellant of its initial assets in exchange for stock, and of decisions on internal corporate matters. They did not constitute "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (Cf. Appeal of Lakehurst Construction Co., et al., Cal. St. Bd. of Equal., Oct. 5, 1965; Appeal of Acme Acceptance Corp., Dec. 11, 1963.)

While appellant maintains that the negotiations for the acquisition of the assets owned by the incorporators constituted doing business, the se alleged negotiations

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were merely matters of decision on internal corporate matters by the Sesnon Interests when they were bringing appellant into a position where it could commence doing business. They did not constitute business done for the purpose of gain or profit by or on behalf of appellant. These earlier events relied upon by appellant involved no binding agreements or negotiations by appellant with third parties. Furthermore, until March 11, 1966, it was the Sesnon Interests, not appellant, who were engaged in the rental activities, (Cf. Appeal of Sam Katzman Productions, Inc., Cal. St. Bd. of Equal., Dec. 18, 1952.)

The activities found to constitute doing business in Golden State Theatre, etc. v. Johnson, 21 Cal. 2d 493 [133 P.2d 395]; Carson Estate Co. v. McColgan, 21 Cal. 2d 516 [133 P.2d 636]; Appeal of Rosenberg Bros. & Co., Inc., Cal. St. Bd. of Equal., April 4, 1960; and Appeal of Kleefeld and Son Construction Co., Inc., Cal. St. Bd. of Equal., June 9, 1960, decisions relied upon by appellant, all involved transactions entered into with outside parties. Furthermore, in all the above decisions, with the exception of Kleefeld and Son Construction Co., Inc., supra, the agreements with outside interests were entered into in the corporate name. In Kleefeld, the activities occurring between the date of incorporation and the crucial date are readily distinguishable in character and scope from those involved in this case. The Kleefeld opinion concerned corporations each of which was wholly owned by one shareholder and was formed for the purpose of entering into a building construction venture with four other corporations. We there held that the taxpayers had commenced business because "Between the date of incorporation of each Appellant and the crucial date of July 16, 1948, each incorporator, for and on behalf of his corporation, was actively conducting negotiations, assembling plans, data, etc., preparatory to the execution of formal agreements with the other participating corporations, suppliers, contractors and the bank."

Our analysis of the facts and the law in the instant case reveals no error on the part of respondent in denying appellant's protest.

## ORDER

Pursuant, to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Two Pine Street Company against a proposed assessment of additional franchise tax in the amount of \$67,004.38 for the income and taxable year 1967 be and the same is hereby sustained.

Ruby Harris, Chairman  
John W. Lynch, Member  
William B. Brown, Member  
Paul Keery, Member  
                    , Member

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